SuperNews Autumn 2012

Death benefits and payments to a former stepchild

The Australian Taxation Office (ATO) late in 2011 released ATO ID 2011/77 which looks at the issue of whether a stepchild ceases to be a dependant of a stepparent for the purposes of paying a superannuation death benefit when the legal marriage of the child's natural parent to the step-parent (and the superannuation fund member) has ended.

The ATO's decision is that a person does cease to be a stepchild for the purposes of being a dependant of the step-parent under Regulation 6.22 of the Superannuation Industry Supervision Regulations (the SIS Regs) when the legal marriage of their natural parent to the step-parent ends by way of divorce or on the death of the natural parent.

The reason for this decision is based on common law, as the term 'stepchild' is not defined in the SIS Regs nor in the Superannuation Industry (Supervision) Act 1993 (the SIS Act)

Dependant for Superannuation Purposes

Subject to limited exceptions SIS Regs provides that death benefits must be cashed in favour of a member's legal personal representative (their estate) and/or one or more of the member's dependants. The term 'dependant' is defined in the SIS Act as including

- the spouse of the person
- any child of the person; and
- any person with whom the person has an interdependency relationship'.

The SIS Act then defines a 'child' in relation to a person, as including:

- an adopted child, a stepchild or an ex-nuptial child of the person, and
- a child of the person's spouse, and
- someone who is a child of the person within the meaning of the Family Law Act 1975.

However, the term 'stepchild' is not defined in the SIS Act or the SIS Regs with the ATO confirming its view its ordinary or 'common law' meaning would apply.

Stepchild at Common Law

At common law, a child ceases to be a stepchild of a step-parent when the relationship between the child's natural parent and the step-parent ends; that is on the death of the natural parent or the divorce of the natural parent from the step-parent.

The ATO cites several cases where the Courts have held the relationship of the stepchild and stepparent does not subsist after the termination of the marriage which creates it; whether by divorce or death. That is, the step relationship only exists while the natural parent is married to the stepparent.

In ATO ID 2011/77 the Commissioner also takes the view.

The ATO has noted the Superannuation Complaints Tribunal (which does not deal with SMSF matters) has followed this common law position when dealing with payments of death benefits for retail and industry superannuation funds. In Superannuation Complaints Tribunal Determination D99-2000\082 the Tribunal set aside the decision of a trustee to pay a member's benefit to the child of the deceased's former spouse on the basis that the child ceased to be a 'stepchild' and 'dependant' of the member when the child's natural parent was divorced from the member.

An example

The ATO in the ruling provides the following example. A member (Michael) of a self managed superannuation fund was legally married to Patricia. Patricia is the natural parent of Sam, who was born while Patricia was married to another person. The marriage of Michael and Patricia ended in divorce. Michael has died and he did not formally adopt the child Sam under any state or territory law.

The trustee of the fund must determine whether Sam is a dependant of Michael because Sam has been a 'stepchild' of Michael.

The ATO has determined that the trustee in this case cannot treat Sam as a stepchild of Michael for the purposes of identifying Michael's dependants.

The ATO does note that Sam may still be a 'dependant' of Michael for superannuation purposes if Sam had an 'interdependency relationship' with Michael, or was otherwise a 'dependant' of Michael within the ordinary meaning (financially dependent on the member), at the date of Michael's death.

An answer in this example could have been for Michael to have had a binding nomination to pay any death benefits to his estate with appropriate provision made for Sam in his Will.

Death benefits can be a complex area and financial advice from your financial adviser may be necessary.

Also in this issue…

Improvements and Limited Recourse Borrowing Arrangements

In September 2007 Superannuation legislation was changed to allow superannuation funds including self managed superannuation funds (SMSFs) to acquire permitted assets by borrowing under what is now known as a Limited Recourse Borrowing Arrangement (LRBA).

Subsequently from 7 July 2010, the old legislation in the Superannuation Industry (Supervision) Act (SIS) under which super fund trustees engaged in these arrangements was repealed and replaced with new Section 67A and Section 67B with the new legislation implementing a number of major changes. One of those changes was that the new legislation allows for borrowed moneys to be used to pay for repairs and maintenance, but not improvements.

In September 2011, the Australian Taxation Office issued draft Ruling SMSFR 2011/D1 which explains key concepts relevant to the application of the LRBA provisions, as those provisions apply to an SMSF that enters into an LRBA. One of the key concepts explained is how to distinguish between 'maintaining' or 'repairing' the acquirable asset as opposed to 'improving' it. In the context of an LRBA, an acquirable asset is therefore any form of property, other than money, that the trustee is not otherwise prohibited from acquiring by the SIS legislation or any other law.

The money borrowed under the LRBA (and secured by the single acquirable asset) may be applied not only in acquiring the acquirable asset but also in carrying out repairs and maintenance to the asset whether necessary at the time of its acquisition or at a later time. However, no amount that has been borrowed by the SMSF trustees under the LRBA may be applied to improve the single acquirable asset.

'Maintaining' means work done to prevent defects, damage or deterioration of an asset, or in anticipation of future defects, damage or deterioration provided that it merely ensures the functional efficiency of the asset is maintained in its present state. 'Repairing' means remedying or making good defects in, damage to, or deterioration of, an asset and contemplates the continued existence of the asset.

In contrast to repair, an asset is improved if the functional efficiency of the asset or the value of the asset is substantially increased through the addition of new and substantial features or rights or bringing a thing or structure into a more valuable or desirable form, state or condition than a mere repair would do.

The following examples illustrate the difference between a repair and an improvement

	Repair or maintenance	Improvement
	A fire damages a part of the kitchen. Restoration of the damaged part of the kitchen would constitute repair of what is a subsidiary part of the asset being the house and land.	If the kitchen was also extended by extension of the house, this extension would be an improvement.
	A cyclone damages the roof of the house. Replacement of the roof in its entirety is a repair.	The addition of a second storey to the house at the time of also replacing the roof would be an improvement.

Subsequent draw downs under an LRBA may be made for the purposes of maintaining or repairing an asset. If draw downs for the purposes of maintaining or repairing an acquirable asset are provided for as part of an LRBA, each draw down is a borrowing under an arrangement that is an LRBA if the arrangement as a whole continues to satisfy the LRBA provisions.

Although borrowings under an LRBA cannot be used to improve a single acquirable asset that is the subject of the LRBA, *money from other sources could be used to improve (or repair or maintain) that asset.* However, any improvements must not result in the acquirable asset becoming a different asset.

Consideration must be given to whether any improvements or other changes to an acquirable asset result in a different (replacement) asset being held on trust under the LRBA in circumstances not covered by section 67B.

The improvements should not result in a different asset as the changes fundamentally alter the character of the asset or the proprietary rights held under the LRBA.

Examples

An SMSF trustee enters into an LRBA where the single acquirable asset is land on which a four bedroom house had been constructed prior to the SMSF entering into the arrangement. The house was severely damaged by fire and the local council required it to be demolished.

- Reconstruction of a house damaged by fire

  As a result of an insurance policy, the four bedroom house was reconstructed using the insurance proceeds.

  As rebuilding the house is restoring the asset to what it was at the time of entering into the LRBA (that is, a house and land) it does not result in a different asset being held under the LRBA. The arrangement continues to satisfy the requirements of the LRBA provisions.

- Construction of a different type of building

  Insurance proceeds are used to construct two, two bedroom units on the land following approval for dual occupancy. The construction of the two units on the land fundamentally alters the character of the land and house that existed at the time when the LRBA was entered into. Consequently, the original asset, being the land and the four bedroom house, has been changed to dual occupancy dwellings resulting in a different asset.

  If the acquirable asset is changed (including by way of improvements) to such an extent that it fundamentally changes the character of the asset such that it becomes a different asset, the exception in section 67A will cease to apply to the LRBA. If the borrowing is maintained the trustee will contravene subsection 67(1).

When the final Ruling is issued, it is proposed to apply to arrangements entered into on or after 7 July 2010 (including an arrangement that is a refinancing of a borrowing of money under an arrangement entered into before, on or after 7 July 2010).

Superannuation Contributions 2011-12

The amount of contributions that can be made to superannuation on behalf of an individual depends on a member's age and the contribution caps.

The contribution eligibility rules are illustrated in the table below.

Age	Member's Employer	
	Superannuation Guarantee	*Voluntary*
Under Age 65	Allowable	Allowable
Age 65 - 69	Allowable	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 70 - 74	Not allowed	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 75 and over	Not allowed	Not allowed

	Member
Under Age 65	Allowable
Age 65 - 69	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 70 - 74	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 75 and over	Not allowed

	Member's Spouse
Under Age 65	Allowable
Age 65 - 69	Only if you have worked at least 40 hours in not more than 30 consecutive days in the financial year
Age 70 - 74	Not allowed
Age 75 and over	Not allowed

The table below summarises the main types of concessional and non-concessional contributions and limits for 2011-12 year as well as the penalties for breaching the caps:

Type of Contribution	Consists of	Annual Limit 2011-12	Breach of Cap
Concessional Contributions	Employer contributions (includes superannuation guarantee and salary sacrifice) Personal contributions where a tax deduction is claimed Certain amounts allocated from a reserve unless the allocation meets the exemptions	\$25,000 if aged under 50 \$50,000 if aged 50 or over on 30 June 2012	Additional tax of 31.5% applies to amounts in excess of the cap in addition to the contributions tax of 15%, making total tax of 46.5% These amounts also count towards the non concessional cap and if that cap is breached can be taxed twice.
Non-concessional Contributions	Personal contributions for which the individual does not claim a tax deduction Contributions made by a spouse Amounts in excess of the concessional contribution cap	\$150,000 Members under age 65 at any time in the financial year may contribute up to \$450,000 by bringing forward up to two future years' entitlements	Tax of 46.5% applies to amounts in excess of the cap

Personal injury contributions may also be permitted.

In addition certain payments made into superannuation are also treated as contributions. Previously they have generally been referred to as "rollovers". These include:

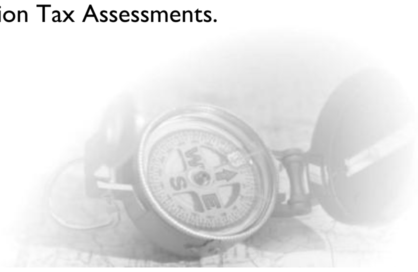
- Capital gains and capital proceeds from disposal of small business active assets transferred into superannuation under the CGT small business lifetime cap of \$1,205,000.
- Foreign termination payments transferred from overseas funds after a person has taken up residence in Australia.
- Directed employer termination payments made into superannuation under the transitional \$1,000,000 employer termination payment cap.

Please contact our office if you need information on these types of contributions.

Breach of Caps

Punitive taxation applies where the contribution caps are breached so care must be taken to ensure contributions to an SMSF are within the caps.

We have seen a number of instances where the contribution caps have been breached in the funds we administer which have resulted in the ATO issuing Excess Contribution Tax Assessments.



Concessional Contributions Cap for over 50s reduces for the 2012-13 financial year

The transitional arrangement for a higher concessional contribution cap for the over 50s will cease effective from 1 July 2012 with the current limit of $50,000 reducing to $25,000 for the 2012-13 financial year.

The Government has announced changes that, if passed by Parliament, will permanently increase the concessional contributions cap to $50,000 for people over 50 who have total super balances below $500,000. However, this is yet to be legislated. The Government is currently liaising with superannuation industry representatives to consider compliance cost issues in relation to this proposal.

Minimum pension payment special relief extended to apply for the 2012-2013 financial year.

The Government recently announced the 25% reduction in pension levels will continue to apply for the 2012-13 financial year. Regulations for this change gazetted in mid February 2012. The table below illustrates the 25% reduction level that applies for the 2011-12 financial year. The table also shows the required minimum pension for each $100,000 of an account balance.

	Reduced Minimum Limits for 2011-12 & 2012-13 Financial years		*All Financial years from 1 July 2013*	
Age	**Minimum payment as % of account balance**	**Annual Pension Level for each $100,000**	**Minimum payment as % of account balance**	**Annual Pension Level for each $100,000**
55 - 64	3 %	$3,000	4 %	$4,000
65 - 74	3.75 %	$3,750	5 %	$5,000
75 - 79	4.5 %	$4,500	6 %	$6,000
80 - 84	5.25 %	$5,250	7 %	$7,000
85 - 89	6.75 %	$6,750	9 %	$9,000
90 -94	8.25 %	$8,250	11%	$11,000
95+	10.5 %	$10,500	14 %	$14,000

In specie transfers of shares to SMSF's to be abolished

Following on from recommendations in the Cooper review, the Government announced late last year that from 1 July 2012 off-market transfers between SMSFs and related parties will be banned.

Historically, off-market transfers have been a mechanism for members to make contributions in specie to their SMSF by choosing to transfer ASX listed shares into their fund without actually selling and re-purchasing the security on the open market.

The Government believes these non-market transactions are not transparent and can be open to abuse. The abuse can occur through transaction date and/or asset value manipulation to achieve more favourable outcomes in terms of contributions caps and capital gains tax. To achieve these aims, the Government will require related party transactions to be conducted through a market, or accompanied by a valuation if no market exists.

This will require the related party to sell the shares on market, contribute the cash into the fund and the Fund then reacquire the shares on market resulting in increased transactions costs due to brokerage being payable. If no underlying market exists, the transactions must be supported by a valuation from a suitably qualified independent valuer. This change is designed to increase the transparency of these transactions and ensure that related party transactions are not used to circumvent legislative requirements.

Trustees have until 1 July 2012 to continue with off-market transactions between related parties and their SMSF. This matter is not yet law and industry groups are lobbying for more suitable guidelines to be put in place.

About Bastion Superannuation Solutions

Bastion Superannuation Solutions specialises in the provision of administration and compliance services to self managed superannuation fund trustees and advisers.

For further information on our range of services please see our web site.

Our range of services include:

- Self managed superannuation fund establishment
- Fund Administration including preparing financial accounts and maintaining member records
- Superannuation compliance and technical guidance
- Group Life Insurance Pool for superannuation fund members
- Assistance with updating self managed superannuation fund trust deeds

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